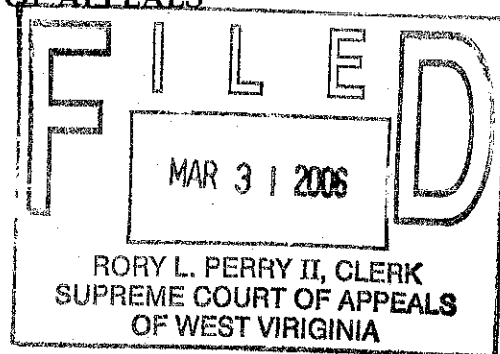


BEFORE THE WEST VIRGINIA SUPREME COURT OF APPEALS

No. 32966



ESTATE OF GARRISON G. TAWNEY, by
LELA ANN GOFF, Executrix,
LELA ANN GOFF and VERNON B. GOFF,
husband and wife, JANICE E. COOPER and
CLIFFORD R. COOPER, husband and wife,
LARRY G. PARKER, JOHN W. PARKER,
RICHARD L. ASHLEY, MYRTLE JONES,
by her Attorney-in-Fact, ORTON A. JONES,

Petitioners/Plaintiffs,

vs.

Civil Action No. 03-C-10E below
Circuit Court of Roane County

COLUMBIA NATURAL RESOURCES, LLC,
f/k/a COLUMBIA NATURAL RESOURCES, INC.,
a Texas corporation; NISOURCE INC., a
Delaware corporation; and COLUMBIA
ENERGY GROUP, a Delaware corporation,

Respondents/Defendants.

**PETITIONERS/PLAINTIFFS' REPLY BRIEF
REGARDING CERTIFIED QUESTIONS**

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I. INTRODUCTION

The defendants who are the lessees (producers) of the subject leases are guaranteed seven-eighths (87.5%) of all monies received from the sale of the oil and gas. Not only do the leases grant to the defendants the right to receive 87.5% of all monies received from the sale of the gas, but the leases also give defendants the exclusive right to enter onto plaintiffs' land, explore for, drill, produce, and transport plaintiffs' gas over plaintiffs' property. All that plaintiffs are to receive for granting all of this to the defendants is 12.5% (1/8) of the amount received for the gas or its value, and, of course, the expectation that the defendants (lessees) will act in good faith. Apparently, seven-eighths was not enough for defendants because, in 1993, they began charging plaintiffs (lessors) for all sorts of expenses identified below. But, defendants never advised plaintiffs of these charges.

The difference in positions between plaintiffs and defendants can be explained by the defendants' primary reliance on authorities from Texas and Louisiana, while plaintiffs rely primarily on the modern and weight of authority from courts like Colorado, Oklahoma and Kansas, and the direct holding of Wellman v. Energy Resources, Inc. 557 S.E. 2d 254 (W.Va. 2001), which plainly adopted the holdings of Colorado, Oklahoma and Kansas.

There is no question but that Texas and Louisiana stand in stark contrast to the holdings in other jurisdictions. Defendants incorrectly claim Texas and Louisiana as representing the majority of courts. As set out below, Texas, in particular, places the interest of the oil and gas producer/lessee paramount over the interest of the lessor,

allowing deductions regardless of language in the lease specifically disallowing for deductions. There is no way to reconcile the two lines of cases or their bases. Either there is an implied covenant to market the gas as set out in Wellman, supra, and in the cases of Rogers v. Westerman Farm Co., 29 P.3d 887 (Colo. 2001) and Garman v. Conoco, 880 P.2d 652 (Colo. 1994), or there is not. Plaintiffs' position is that West Virginia has clearly spoken on the issue in Wellman and that defendants cannot deduct gathering, processing, dehydration, line loss, compression loss, etc. for all the reasons set out in the above cases unless specifically and unambiguously set forth in the lease itself.

Defendants claim that Wellman recognizes that "at the well" language means that deductions can be taken if they are proven to be reasonable and incurred. But the language defendants are quoting does not say that and, in any event, was dicta and the West Virginia Supreme Court in Wellman made no such holding.

Defendants argue that the lease language in all the leases of plaintiffs, excepting flat rate leases, plainly, clearly and unambiguously allows for these deductions. However, if defendants/lessees intended that their lease granted them the right to deduct expenses, defendants/lessees should have included a provision to the effect as follows:

The lessor will be paid a royalty one-eighth (1/8) of the price received (market price, gross price, net price, etc.) at the wellhead, which amount will be arrived at by taking the total price received by lessee from any person, firm or corporation to whom lessee deems appropriate to sell the gas, at any place lessee deems appropriate at which to deliver it and sell it, and subtract therefrom the items set forth below as lessor's share of costs. The result will be deemed the price of the gas at the wellhead and the

lessor's one-eighth (1/8) shall be computed from that equation. The lessee reserves the right to sell the gas to its own wholly owned subsidiaries or to sell the gas in exchange for a discounted loan. The items to be deducted include but are not limited to the following:

1. Costs;
2. Operating costs;
3. Return on investment;
4. Return on investment of fixed assets;
5. Depreciation;
6. Employee salaries and benefits;
7. Uncollectable accounts;
8. Regulatory Commission expenses;
9. Income taxes;
10. Cost of royalty payments to owners;
11. Capital investment;
12. Budgeted additions, including additional capital improvements to the gathering system, new lines, compressors, etc.;
13. Accumulated deferred taxes;
14. O&M (Operations and Maintenance), which include identifiable costs directly associated with the gathering facilities such as maintenance, materials and supplies;
15. O&M allocation to A&G (Administrative and General), which includes operation and maintenance, administrative and general;
16. Franchise taxes;
17. Property taxes;
18. State income taxes;
19. Federal taxes;
20. Line loss, which is a level of gas lost in the gathering system between its point of receipt from the wellhead to where CNR would deliver it to the transmission pipeline grid or ultimate consumer. This is "usually attributable to leaks";
21. Fuel cost, which is gas used to run CNR's compressors;
22. Assumed rate of inflation (Warnick at 119); and
23. Processing fee.

Of course, the lease did not say that. No reasonable person would ever sign such a lease. But, the above is what defendants/lessees asked the trial court to read into the lease language of plaintiffs' leases. Defendants point out examples of leases, which they claim allow for deductions, as follows:

1. "1/8 of the price (net of all costs beyond the wellhead) received by lessee for all gas and the constituents."¹

This particular provision does not say lessor would be paid one-eighth (1/8) of the price at the wellhead. It simply says "1/8 of the price received." This statement does not, therefore, require the establishment of the market price at the wellhead. What it adds, however, is "net of all costs beyond the wellhead." Defendants contend that "net of all costs beyond the wellhead" means that they can deduct this "expense" to get the gas from the wellhead to the meter at the Columbia Gas Transmission line where it is sold. Had defendants used the term "net profit" or "net remaining after deducting transportation, processing, line loss, etc.," defendants could have a better argument.

"Net," according to Webster's International Dictionary, Twentieth Century Dictionary, means: French - "net-clear, clear, pure"; Latin - "*netidus*, clear, shining"; "Free from all deductions," "Not subject to any deduction." "Of" may be defined as "from." Id. See also Webster's New International Dictionary of the English Language, 2nd Ed., Vol. II, 1938. Literally, therefore, "net of all costs beyond the wellhead" means "free or clear from all costs beyond the wellhead."

If you interpret the phrase the way defendants suggest, it would permit the defendants to deduct "all costs beyond the wellhead," including all the way to the ultimate consumer. This would be an absurd result. What does "1/8 of the price, net of all costs received" beyond the wellhead mean? It means that the landowner will receive

¹ It should be noted that defendants never paid plaintiffs anything for the constituents (NGLS) removed and sold from the gas even though they were quite valuable.

1/8 of the price without deduction beyond the wellhead. It is included in the language to actually emphasize that there will be no deductions -- not to allow for deductions.

2. "[T]o pay . . . 1/8 of the wholesale market value thereof at the well based on the usual price paid therefore in the general vicinity."

This is a 1956 lease and plaintiffs claim that it clearly provides that they will be paid one-eighth (1/8) of the market price at the Columbia Gas (TCO) meter, which would be deemed the "general vicinity." There is nothing in this lease providing for defendants to deduct costs. "At the well" means the place where the gas is measured, but the value or price is determined by the index price. There is no indication or statement that the price would be reduced for anything. "Wholesale price" simply means that it is not retail to customers. It is the index price where purchasers buy and sell gas as it enters the pool.

3. "1/8 of the gas produced from each well . . . at the rate paid for gas at the well or wells on adjacent lands or in the immediate vicinity."

This is a 1928 lease and plaintiffs claim that lessors are to be paid the market value or index price in the vicinity or immediate vicinity which would be the index price at the TCO meter.

4. ". . . [O]ne-eighth of the revenue realized by Lessee for all gas and the constituents thereof produced and marketed from the leasehold. . ."

Plaintiffs claim again that this provision clearly requires the lessee to pay one-eighth (1/8) "revenue realized," which would be the good faith price received or which could have been received for the gas.

Defendants contend that "all [leases subject in this case, including the above] contain provisions explicitly providing that the point of valuation of the gas for purposes of the payment of royalty is at the well, not at a downstream delivery point. . . ." From this assumption defendants claim that the leases "explicitly" call the point of valuation for royalty "at the well." Defendants then invent their own method of evaluating the "price," the "revenue," the "gas produced" by saying they cannot sell it at the well so they transport it, process it, and deduct all those costs. None of the leases provide for doing that.

Plaintiffs also take exception with defendants' representations in their brief that 1382 leases "have language stating that royalty is to be calculated 'at the well' or 'at the wellhead' or specifying that the royalty is to be calculated 'net of all costs beyond the wellhead' or specifying that the royalty is to be less all taxes, assessments and adjustments." Defendants' Brief at 1, emphasis supplied. While those phrases were used in various ways in the leases, never was it stated or "specified" clearly or even ambiguously that royalty was to be "calculated" at the well. The defendants take the liberty of asserting this in order to justify what they did, which was to surreptitiously charge plaintiffs for defendants' own expenses in producing and transporting the gas to TCO's meter.

II. ARGUMENT AND AUTHORITIES

A. The Certified Questions Are Proper.

Defendants first raise the propriety of the trial court's certified questions. Defendants' Brief at 1, 14, 22. Defendants' argument has no basis in fact or law. First,

the trial court speaks only through its orders. Elmore v. State Farm Mutual Auto Ins. Co., 202 W.Va. 430, 504 S.E.2d 893 (1998). The trial court's statement that, "I'm going to direct that the lawyers get together and certify it" demonstrates that the court meant to certify the questions relevant to the defendants' motion and meant to include the attorneys for both parties' positions before entering the order. Hearing Tr., 9/19/05, at 100-101. Further, defendants argue that their motion for summary judgment only addressed a portion of the leases involved in the class action. However, the defendants' motion for summary judgment was broad enough to include essentially all of the class' leases.² Defendants seem to suggest that the trial court should not have certified the questions to include any lease language except the representative plaintiffs. What purpose would the certified questions serve in deciding only some issues for the class action? Obviously, the trial court has an interest in addressing all of the law involved in the questions certified.

The defendants cite Kincaid v. Mangum, 189 W.Va. 404, 432 S.E.2d 74, Syl. 3 (1993) and Baier v. City of St. Albans, 128 W.Va. 630, 39 S.E.2d 145, 149-150 (1946) for the proposition that the trial court committed error by posing certified questions that addressed all of the law applicable to the questions. However, those cases contradict defendants' position. In Baier, supra, at 149-150, the Supreme Court states:

² Defendants argue that the certification includes leases, which defendants admit they cannot take deductions from. The defendants testified that both royalty and deductions were made to all of the leases irrespective of the lease language, except for flat rate leases. Obviously, flat rate leases should not have deductions for gathering and processing. However, plaintiffs have discovered that defendants have not properly converted many flat rate wells and these questions will affect some flat rate leases.

Ordinarily in a certified case, this Court confines itself to answering the specific questions certified, but these preliminary questions being of interest to the public, and having some bearing, at least, upon the questions certified, we think their discussion at this point both proper and advisable.

Id. at 149-150. Therefore, certified questions may be expanded in breadth to appropriate issues of law that allow for resolution of legal issues which have some bearing on the questions. Defendants cite law allowing for expansion of the issues as authority to limit the questions and issues in a complex class action. The questions certified were appropriate and an order was entered by the trial court after due and deliberate consideration. Therefore, defendants' motion to reformulate the questions should be denied.

B. At The Wellhead Language Alone, As Used In The Leases, Does Not Give Lessee The Right To Deduct Lessees' Expenses.

As justification for their deductions, defendants rely heavily on the language "at the well" or "at the wellhead." Defendants' Brief at 1, 3, 4, and 6. Defendants' argument as to what "at the well" means might be characterized as creative thinking instead of reasonable interpretation. Defendants claim that an average, normal and reasonable person would read the statement "to pay . . . at the well" as meaning:

1. "There are 1382 (leases that) have language stating that the royalty is to be calculated at the well or at the wellhead." Defendant's Brief at 1;
2. "[A]ll [leases] contain provisions explicitly providing that the point of valuation of the gas for purposes of the payment of royalty is at the well, not . . . down-stream." Defendant's Brief at 3;
3. "The deductibility language in the lease, (i.e. "at the well") is clear and unambiguous." Defendant's Brief at 4; and, therefore,

4. "They [plaintiffs] fail to acknowledge the plain and unambiguous language in the leases ("at the wellhead") which expressly authorize the deduction of costs incurred down-stream of the wellhead." Defendant's Brief at 6;

In order to make these giant leaps over common sense and the English language, one must assume that from reading the words "1/8 of the proceeds [or other such language] at the wellhead" it is clear that the lessee is free to pay to its lessor 1/8 less whatever deductions lessor deems appropriate. This language was never meant to inform the lessor that he would be required to pay for anything whatsoever. That is borne out by the fact, as admitted by defendants, that lessors were never charged for gathering, line loss, processing, etc., until 1993. If the "at the well" language meant the lessor was to be charged for all of these so-called "post production" costs,³ why were they not always charged for them? Defendants admit that the costs were paid for by the purchaser of the gas, Columbia Transmission Corporation (TCO), or their customers.

Defendants argue that Wellman v. Energy Resources, Inc., 557 S.E.2d 254 (W.Va. 2001), does not mean what it says. Defendants ask the Court to ignore the express holdings in Wellman, that there is an implied covenant to market the gas which means lessee pays to make it marketable and pays to transport the gas to a marketable location. The West Virginia Supreme Court, in Wellman, called that the "point of sale." As the Wellman Court held: "the lessee MUST bear all costs incurred in exploring for, producing, marketing and transporting the product to the POINT OF SALE." Id. at 265.

³ Some authorities view transportation, gathering, etc., to be "production expenses." Maurice H. Merrill, Covenants Implied In Oil and Gas Leases, § 85 at 212 (2d Ed. 1940).

To overcome this clear holding, CNR turns to dicta, in Wellman. It should not be forgotten, however, that Wellman adopted the Colorado, Oklahoma and Kansas line of cases. Colorado, in Rogers v. Westerman Farm Co., 29 P.3d 887 (Colo. 2001), when faced with language that might grant lessee the right to deduct, found "at the wellhead" to be ambiguous and, therefore, "silent" as to whether lessee had a contractual right to deduct post-production expenses. Since Wellman and Rogers were published at the approximate same time, Wellman did not have the benefit of the holdings in Rogers.

But, regardless, the defendants are asking the Court to interpret a vague and ambiguous phrase "at the wellhead" as granting to them the right to take numerous deductions off of the lessor's one-eighth (1/8). Defendants' assertion that "at the wellhead" is not ambiguous is the cornerstone of their whole argument.

Defendants first state, as if true, that "at the wellhead" is unambiguous language; then defendants surmise that a lessor should know that his one-eighth (1/8) means 1/8 minus anything the defendants could dream up to charge against his 1/8. As set out below, "at the wellhead" could have any number of meanings to a lessor, which has nothing to do with whether lessee has a right to deduct items from lessor's royalty.

1. "At the wellhead" does not mean the place where the gas is sold. It means that the gas is to be measured at the wellhead. As set forth extensively in plaintiffs' brief, gas is not sold in West Virginia at the wellhead and there is no price for it at the wellhead. Defendants freely admitted this in 30(b)(7) depositions. Plaintiffs' Brief at 4-6. The "point of sale" as defined in Wellman is the place where the gas is valued because that is the first place where it is in a condition and location where it could

possibly be sold in the market. Defendants try to justify their position by saying that there is a market price at the wellhead if one takes the market price somewhere else and then deducts all of the things necessary to make it marketable. This clearly violates Wellman's holdings and common sense.

2. In 1993, Henry Harmon, President of CNR, asked for recommendations from defendants' staff as to whether they should or could make deductions from royalty. If it were so clear and unambiguous, why would they need such intra-office debate and documentation?⁴ If it were so ambiguous to the lessee that defendants had to debate whether they could take deductions, why then would it not be even more ambiguous for the lessor who never prepared the lease? The motive for CNR debating whether to make these deductions was not whether they had a contractual right; it was whether they could gain financially by doing this. (See Bates No. CNR1128-30.)

3. Defendants had a duty to prepare their leases so that a lessor could understand what the lessor was getting and what CNR could deduct, if anything. Wellman v. Energy Resources, Inc., 557 S.E.2d 254 (W.Va. 2001). CNR did prepare some leases with clear and specific language which allowed for deductions. This proves CNR doubted that "at the wellhead" language was sufficient to permit legal deductions. It certainly demonstrates that defendants knew how to prepare a lease that anyone could read and understand.

⁴ Defendants chose to take these deductions after much debate as to whether it was appropriate to do so. But, they never disclosed it to their lessors. Instead, they claimed zero (-0-) deductions.

4. Volumetric deductions, which defendants admit they regularly took from plaintiffs, are not mentioned in defendants' brief. There is no explanation for defendants deducting volume. Defendants cannot point to any lease, any custom or practices, or any law that allows them to deduct volume from calculations to arrive at royalty owners' checks.

5. CNR then says that the only time there is an implied duty to market "is when the lease is silent." Again, this is not true. The implied duty is always there unless clearly altered by terms and provisions that allow for deductions. Wellman made this clear. Wellman, 557 S.E.2d at 264-265.

6. As set forth in plaintiffs' initial brief, there is no doubt as to the relevant facts pertaining to the subject leases. The gas had no market at the well. (Plaintiffs' Brief in Support of Certified Questions at 4.) It had to be transported and processed to make it marketable so it could be sold. Defendants continue to argue, however, that the lease language provides for deductions claiming that there is a market for West Virginia gas at the wellhead. Defendants sold their gas to their own subsidiaries, in sweetheart deals, to hedge deals and always into a pool for a pool price. (Chandler Tr., at 53-54, 63, 99.) Also, defendants do not even meter at the wellhead. How can CNR claim wellhead price when the sale is never at the wellhead? (Harmon Tr., at 144; Charlotte Cullifer Tr., at 8-10.)

C. Market Price, Net Of All Costs, Gross Proceeds, Etc., Are Ambiguous Phrases That Do Not Permit Deductions From Royalty.

When defendants prepare the lease, sell the gas, collect the money and then pay the royalty owners their share, obviously, lessors/royalty owners are at the mercy of defendants. When defendants explain on page 38 of its brief that "gross proceeds," "market price," "net of all costs" and such language tells lessors that defendants have a right to deduct line loss, etc., they must throw out all rules of contractual construction first. Applying the strict construction standard to favor lessors, "gross proceeds" should mean all the money defendants receive for the gas. "Market price" should mean the "fair market value" or price received for the gas unless it is less than market price.

All of the above demonstrates why the Colorado Supreme Court ultimately concluded that trick words and phrases thrown into the royalty clauses are not sufficient notice to a landowner if a lessee wishes to deduct their own expenses from lessor's 1/8 (12.5%). It would seem that 7/8 (87.5%) deduction from 100% of the gas should be enough. Wellman held that if deductions are going to be taken, lessor MUST SPELL IT OUT. The lessor could easily state exactly what items should be deducted. Why, then, would they insert short, confusing statements which were never enforced until 1993?

Defendants ignore the fact that historically the lessors expected to receive their 1/8 as a royalty, not 1/8 minus costs. The West Virginia Supreme Court recognized "lessor expectation" as a valid basis for interpreting the lessee/lessor relationship and lease language. Wellman, supra, at 264. Professor Anderson, whom defendants cite for

support of their own position, explained that over the last 50 years lessees have sought, through vague and ambiguous lease language, to mislead lessors into believing they are getting paid a certain stated percentage royalty when, in fact, they are unknowingly deducting monies from the royalty. Id. at 633-635. As Professor Anderson stated:

First, they could have clearly stated their objective. Second, their chosen language is susceptible to a construction that is more in harmony with the royalty clause as a whole. Third, **an oil and gas lease offered by a lessee should be construed against the lessee.** If "at the well" is reasonably construed and harmonized with the rest of the royalty clause, which calls for payment on the basis of "proceeds," "amount realized," "market price" or "market value," the gas royalty clause is capable of a more rational and plain meaning—albeit a meaning that is not fully in accord with the objective of the lessees who drafted this language.

Owen L. Anderson, Royalty Valuation: Should Royalty Obligations Be Determined Intrinsically, Theoretically, or Realistically, Part 2 (Should Courts Contemplate the Forest or Dissect Each Tree?), 37 Nat. Resources J. 611, 636-37 (1997) (emphases added; footnotes omitted).

There is no question but that the market for gas in West Virginia is not at the wellhead. Further, the market price and price realized, wholesale price, net price, etc., all mean the amount the lessee gets for the gas. For example, if the amount realized is significantly less than the market price, the lessee is violating the "prudent operator rule." The market price should fairly equate to the amount realized. "Wholesale price" presumably means the price before it is sold to ultimate consumers. Net price is presumably the amount the lessee gets from whomever they sold the gas to less any charges by that purchaser -- not charges by lessee/seller.

It certainly could not mean net after deducting all of lessees' overhead, etc. At the very best, all of these fade away into the fog of ambiguous and inconsistent statements of royalty, which CNR, Columbia Energy Services (CEG), Columbia Energy Resources (CER), Columbia Energy Group (CEG) and NiSource themselves found unmanageable and without meaning and, therefore, knowingly disregarded by paying everyone on the same basis and deducting the same way by using a postage stamp rate.

The West Virginia Supreme Court of Appeals has agreed that oil and gas leases are to be strictly construed against the lessee with any ambiguity resolved in favor of the lessor. Martin v. Consolidated Coal & Oil Corp., 101 W.Va. 721, 133 S.E. 626, 628 (1926) ("it is a recognized doctrine of this Court that oil and gas leases generally are to be construed liberally in favor of the lessor and strictly against the lessee."); Flanagan v. Stalnaker, 216 W.Va. 436, 607 S.E.2d 765, 769-770 (2004) (quoting above holding of Martin and also noting that "[t]he question as to whether a contract is ambiguous is a question of law to be determined by the court" and that an ambiguity may be "[a] latent ambiguity [which] arises when the instrument upon its face appears clear and unambiguous, but there is some collateral matter which makes the meaning uncertain").

In keeping with the above widely accepted doctrine numerous scholars have noted that oil and gas leases are the equivalent of insurance contracts insofar as being contracts of adhesion, which are not truly bargained for in an arms length transaction.

Professor W. W. Thornton has explained:

[Oil and gas leases] are looked upon somewhat in the same light as contracts of insurance. By long experience insurance companies have been enabled to draw a policy which is often difficult to determine just what their liability may be. They have their attorneys who have spent years in studying contracts of insurance and the decisions of the courts, until they have become thoroughly versed in all phases of such contracts. On the other hand, the insured is usually without advice when entering into a contract of insurance, and he is almost universally ignorant of the rules of law applicable to such obligations. To such an extent is this true that the courts have adopted a construction, in cases of doubt or obscurity, favorable to the insured. What is true of insurance contracts,⁵ may be said to be true of oil or gas leases (if not mining leases). The lessor usually knows nothing of the law applicable to such instruments; while the operator is usually well informed. Years of experience have shown the operator how to draw a lease giving him many advantages, of which the lessor has not even thought. For this reason the courts have adopted a rule to the effect to construe an oil and gas lease most favorably to the lessor, where its terms can be so construed without doing violence to the language used.

1 W. W. Thornton, The Law Relating to Oil & Gas, § 251 (1925).

Lessees should not be rewarded in the end for not using plain language and for not plainly stating in the leases exactly what they proposed. To do that would mean

⁵ In regard to insurance contracts, the West Virginia Supreme Court of Appeals has held:

In applying the doctrine of reasonable expectations to standardized insurance contracts, we must reject that portion of the reasoning in Soliva which is based on the general rule that a party to a contract has a duty to read the instrument. While this rule may equitably be enforced with regard to a contract negotiated at arm's length between parties of reasonably equivalent bargaining power and signed by each, it would be unfair to apply the general rule in the case of the modern insurance contract. These policies are contracts of adhesion, offered on a take-it-or-leave-it basis, often sight unseen until the premium is paid and accepted, full of complicated, almost mystical language. "It is generally recognized the insured will not read the detailed, cross-referenced, standardized, mass-produced insurance form, nor understand it if he does." C & I Fertilizer, Inc. v. Allied Mutual Insurance Co., 227 N.W.2d 169, 174 (Ia. 1975); accord 3 Corbin on Contracts § 559 (1960); Keeton, 83 Harv.L.Rev. at 968. The majority rule is that the insured is not presumed to know the contents of an adhesion-type insurance policy delivered to him, 7 Williston on Contracts § 906 B (1963), and we hereby adopt the majority view.

National Mutual Insurance v. McMahon & Sons, 356 S.E.2d 488, 495-96 n. 6 (W.Va. 1987).

that a landowner might not agree or lease to a competitor, something no gas company wants to encourage -- competition. As Professor Anderson wrote:

Lessees believed that this objective could be achieved through use of the "at the well" phrase. Although lessees knew how to state their objective more clearly, they did not wish to address post-wellhead costs directly, such as by stating that the lessor "shall bear a proportionate share of post-wellhead expenses incurred in marketing the gas." This direct language was avoided because lessors would be too easily alerted to the objective and could then amend the clause by inserting the word "not" between the words "shall bear."

Anderson, *id.* at 633-35 (emphases added; footnotes omitted).

Defendants in this case wrote some leases specifically mentioning some deductions. Regardless of the nature of the lease language in those 56 leases,⁶ it definitely proves that defendants could have done that for all leases except they did not want lessors to know their true intent.

Generally, a contract is considered ambiguous if it is reasonably susceptible to more than one construction. Harris v. Harris, 212 W.Va. 705, 575 S.E.2d 315 (2002); Griffin v. Fairmont Coal Co., 59 W.Va. 480, 53 S.E. 24 (1905). Ambiguity in a contract must be resolved against the party who prepared it. Nisbet v. Watson, 162 W.Va. 522, 251 S.E.3d 774 (1979); Combs v. McLynn, 187 W. Va. 490, 419 S.E.2d 903 (1997). Moreover, an obligation is construed most strongly against the obligor. Bank v. Green, 45 W.Va. 168, 31 S.E. 260 (1898). He must take care to use intelligible words to express any condition he may wish to impose on his obligation. Id.

⁶ See Affidavit of Michaelle Hays attached as Exhibit A to Plaintiffs' Response to Defendants' Motion for Summary Judgment Regarding Post-Production Deductions.

Thus, here the leases should be resolved against the lessees and in favor of the lessors. Here, since lessees prepared the leases, the lessees should have used intelligible and unambiguous language if they wished to impose any costs upon the lessor.

Finally, in construing a contract, courts should take great care not to make the contract speak where it was intentionally silent. Leckie v. Bray, 91 W. Va. 456, 113 S.E. 746 (1992). Lessees cannot reasonably claim that they spelled out that expenses would be deducted. As stated above, the leases here are not only ambiguous but are also silent with respect to the allocation of costs. Since lessees could have expressed their desire to allocate costs to the lessors but failed to do, this Court should take great care not to make the contract speak where it is silent.

D. Defendants' Lease Language -- Ambiguous Terms In An Oil And Gas Lease Are Strictly Construed Against The Lessee -- Is Silent With Respect To Deductions.

The only party that knew one-eighth (1/8) did not mean 1/8 was the lessee who controlled the computer. It truly takes a tortured interpretation of the law and the facts to arrive at defendants' conclusions.

Defendants begin their argument by putting the cart in front of the horse. That is to say, defendants begin their analysis by first assuming that "at the well" language and other such language in the leases are clear and unambiguous. Therefore, they submit that such language must be applied rather than construed by the Court. In doing so, defendants ignore the following: (1) courts and scholars have nearly uniformly acknowledged that oil and gas leases are contracts of adhesion, which are not truly bargained for in an arm's length transaction between parties of equal bargaining

strength and which do not contain terms that are typically clear and unambiguous to both parties; (2) courts and commentators have specifically acknowledged that “at the well” or “wellhead” language is not clear and unambiguous to lessors as to how the royalty amount is to be calculated and what deductions, if any, will be taken; and (3) designated agents, officers, and/or employees of defendant CNR have admitted that they did not look at the leases to determine whether and what deductions could be made but instead treated all lessors uniformly.

In Rogers v. Westerman Farm Co., 29 P.3d 887 (Colo. 2001), the Colorado Supreme Court was faced with four types of lease language pertaining to approximately 200 natural gas wells; all of which provided, with some variation, for royalties to be paid based on the gas “at the well” or “at the mouth of the well.”⁷ The Court was required to determine whether such language was “sufficiently clear to set forth the proper allocation between the parties of the costs of gathering, compressing, and dehydrating the gas prior to its entry into the interstate pipeline.”⁸ Rogers, 29 P.3d at 891.

⁷ A review of Exhibit A to the trial court’s Order certifying these questions demonstrates that while there are variations to the language, the phrases “at the well,” “amount realized,” “revenue realized,” “price received,” “net revenue realized,” “market price,” “gross amount,” “value of gas,” “all money received,” “selling price,” etc., none of them state that price or royalty is to be calculated by reducing the price by deducting expenses.

⁸ It is admitted that Anderson criticizes other aspects of Rogers v. Westerman Farm Co., 29 P.3d 887 (Colo. 2001); for example, that Rogers bases the “first marketable condition” rule on the implied covenant and not on the plain meaning of “production.” But, Robert Donley’s, The Law of Coal, Oil and Gas in West Virginia and Virginia § 104 (1951) and Maurice H. Merrill’s, Covenants Implied In Oil and Gas Leases, § 72 (2d Ed. 1940) are squarely in the corner of Rogers and Wellman. Anderson contends that processing and gathering should be considered production.

When framing its issue, the Rogers Court initially stated:

We first note that there are four variations of lease language at issue in this case. However, notwithstanding the distinct language of each of the four lease types, there is some language common to all four lease types. **Specifically, all of the leases contemplate that the royalties are to be computed “at the well” or “at the mouth of the well.”** We have not previously interpreted the type of lease language presented by the leases at issue in this case. Despite the differing language in each of the four types of leases, and despite the arguments raised that the “at the well” and “at the mouth of the well” language provides for the allocation of costs, **we conclude that all of the leases are, in fact, silent with respect to the allocation of costs.**

Id. at 896-897, (emphases added).

The Rogers Court noted:

[I]n interpreting leases like those in this case, we are mindful of the generally accepted rule that oil and gas leases are strictly construed against the lessee in favor of the lessor. Wilson v. Wakefield, 146 Kan. 693, 72 P.2d 978, 980 (1937); Ladd v. Upham, 58 S.W.2d 1037, 1039 (Tex.Civ.App.1933); Davis v. Cramer, 837 P.2d 218, 225 (Colo.App. 1992) (oil and gas leases are construed liberally in favor of lessor and strictly against lessee); Hill v. Stanolind Oil & Gas Co., 119 Colo. 477, 489, 205 P.2d 643, 649 (1949) (doubt as to contract’s meaning should be resolved against the one who prepared it); Anderson, Part 2, supra, at 636 (“an oil and gas lease offered by a lessee should be construed against the lessee”); 2 W.L. Summers, The Law of Oil and Gas § 372, at 487-94 (1959 & 2000 Supp.) [hereinafter Summers] (uncertainty or ambiguity as to meaning of contract will be construed against party who prepared the contract; in oil and gas industry that is usually the lessee).

Id. at 901-902, (emphasis added)⁹.

⁹ Plaintiffs note that any criticism of the Rogers decision by Professor Owen Anderson due to the Colorado Supreme Court’s holding that the marketable condition rule also has a marketable location component is irrelevant to the facts of this case because the gas at issue herein is not in a marketable condition until or after it reaches a marketable location. However, it is surprising that he would choose to criticize the Colorado Supreme Court for its decision in Rogers while in his prior article cited by plaintiffs he praised its decision in Garman as being the most reasonable and rationale approach taken by courts and also seemed to suggest in such article that a marketable location was an important factor under the marketable condition rule.

If defendants wanted lessors to pay all costs¹⁰ beyond the wellhead, why didn't they say: "Lessors are responsible to pay all costs of gathering, processing, line loss, etc., plus you will have a percent of volume deducted also from your one-eighth (1/8) of the gas sold from the well to the point of sale."? Plaintiffs are certain that it was not the lack of space to write the words. Or, how about: "You will be paid one-eighth (1/8) of the price of the gas based on a calculation of price received minus all costs from the wellhead, including . . ."?

As stated above, if such phrase has more than one reasonably susceptible meaning, it must be construed in favor of the lessor. Martin v. Consolidated Coal & Oil Corp., 133 S.E. at 628. It is abundantly clear and plainly admitted that the defendants recognized this rule in the way they treated each of the lessors in this class -- identically. They were put in a computer and paid the same out of a pool, standard deductions charged to them, and the lessors received accountings which showed no deductions. In this regard, it should be noted that a party to a contract may waive its right to enforcement of a provision of the contract by adopting a mode of performance. 17A Am.Jur.2d, Contracts § 635. Here, defendants chose to pay plaintiffs based in a common manner regardless of the royalty clause terms. Plaintiffs submit that defendants were entirely wrong in doing so without the knowledge and consent of the lessors, but, in any event, they should not now be heard to claim that they can rely on

¹⁰ Even if such were not the case, without the lessee expressly listing and defining the various potentially applicable costs, how would a lessor know what costs are at issue? Accordingly, in either event, such phrase is neither clear nor unambiguous.

the terms of certain leases to justify deductions from plaintiffs' royalty when they did not rely upon such language to do so in the first instance.¹¹

E. Rogers v. Westerman Farm Co. Is Not A Radical Departure From Existing Law.

Defendants claim that Rogers v. Westerman Farm Co., 29 P.3d 887 (Col. 2001), is a "minority rule," a "radical minority rule," which has the potential to "drastically alter royalty payment methodology for all oil and gas producers in the state." Defendants' Brief at 4. Further, defendants claim that the trial court acknowledged as much. Defendants' Brief at 4. First, Rogers, supra, has not been "roundly criticized." Professor Anderson generally supports most of Rogers' holdings. The trial court did ask about the criticism of Anderson, but it was prompted by defendants' counsel's argument. Defense counsel, in their brief, left out the last two sentences of the trial court's questions where the trial court corrected the statement and said, "I don't think it's fair to say "roundly [criticized]." Maybe it's been criticized, at least, by commentators." Hearing Transcript, September 19, 2005, at 96:8-10.

It is fair for defendants themselves to criticize Rogers, supra, but it is not fair to misrepresent what the court said. Actually, Rogers is consistent with the decisions in North Dakota, Arkansas, Kansas, Oklahoma and Colorado, which hold that there is an implied covenant for lessee to market the gas, which includes the duty to process it and make it marketable at a point of sale. Garman v. Conoco, Inc., 886 P.2d 652 (Col. 1994);

¹¹ This course of dealing, usage or custom of the defendants in ignoring the terms of their specific leases and treating all lessors uniformly in calculating royalties and making deductions constituted a waiver on their part of their express rights under the leases and they should be estopped from asserting that their actions were permitted by the express terms of any of their leases.

Wood v. TXO Production Corp., 854 P.2d 880, 882 (Okla. 1992); Gilmore v. Superior Oil Company, 388 P.2d 602 606 (Kan. 1964); Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563, 565 (Ark. 1988); West v. Alpar Resources, Inc., 298 N.W.2d 484, 491 (N.D. 1980).

What Rogers did was simply say the same thing that Wellman v. Energy Resources, Inc., 210 W.Va. 200, 557 S.E.2d 254 (2001), said. Rogers held that there is a duty owed by the lessee of an oil and gas lease to make the gas marketable as a product and as to its location (Rogers, supra, at 905), while the West Virginia Supreme Court, in Wellman, supra, held that the lessee must bear all costs incurred in . . . marketing and transporting the product to the point of sale." Wellman, supra, at 265.

Owen L. Anderson's A Royalty Odyssey, 53rd Annual Institute for Oil & Gas Law, 2002 ("Anderson V"), his fifth publication, which, in a few respects, is contrary to his first four publications, did criticize some features of Rogers. However, Anderson does not appear to criticize the most important holdings in Rogers. Mr. Anderson's criticism is directed in large part to the "location" portion of the marketability test and more particularly to Rogers' refusal to distinguish between "long distance transportation" versus "gathering." Anderson V at 16-17.

First of all, the "long distance transportation" portion of the Rogers decision (Rogers at 892) appears to be *obiter dictum* because the only issues in Rogers were costs incurred before delivery to the interstate pipeline. Secondly, long distance transportation was not involved in Rogers, because the plaintiffs there conceded that transportation costs after delivery to the pipeline terminal were proper deductions. Third, plaintiffs, in the case at bar contend that they should not be charged deductions

for transporting the gas to the TCO pipeline. Long distance transportation is not the issue in this case. Therefore, the Rogers dicta in regard to "distant" locations is nothing but a red herring as to criticism of Rogers or as to its applicability to this case.

F. IOGA's Agreement Does Not Allow For Deductions From Plaintiffs' Royalty (FERC).

Defendants argue also that it is undisputed that they actually incur the charges they deduct from plaintiffs' royalty checks and they say that the amount was reasonable because the gathering fees were approved by the Federal Energy Regulatory Commission (FERC). Defendants' argument fails because while plaintiffs agree that they do not contest the FERC rate, defendants do not contend nor can they contend that FERC requires and forces them to charge the landowner/lessors for all the fees they charge to producers for transportation.

First, defendants do not contend that FERC has jurisdiction over lessors' rights in West Virginia. Neither do defendants contend that FERC decides what to charge or not charge and to pay or not to pay West Virginia landowners/lessors (royalty owners) for their gas. That issue is between lessee and lessor based on the law of West Virginia and defendants do not contend otherwise.

Second, the FERC approved gathering fees referred to by defendants in their brief were arrived at by negotiations -- not by litigation and decisions by FERC.

Third, the issue before FERC was how much "producers" were going to have to pay to transport gas over the "gathering facilities," not what plaintiffs/lessors were

going to pay. The producers, like CNR, receive 7/8 (87.5%) of all the price received for the gas to drill for and transport it to sell it.

The issue before FERC was never whether or how much a West Virginia landowner could be charged by defendants for all of defendants' services or whether they had a right to charge them anything under the law of West Virginia.

Fourth, the contest at FERC was between CNR (a producer who also owned the gathering facility from 1995-1997) and other producers. All of these entities, CNR and other producers (Independent Oil & Gas Association IOGA) were in the same general situation. They each owned wells on leases where they needed to transport the gas from wells to TCO lines. All received a working interest of 7/8 (87.5%) of the income from sale of the gas. FERC had approved CNR buying at depreciated cost all of TCO's gathering facilities. Now FERC required CNR to allow these independent producers to use CNR's lines.

Fifth, the resolution of this fight between IOGA and CNR was CNR could charge the independents for running gas through CNR's gathering lines. This included charges for everything from taxes to overhead at the office to return on investments. That may be fair for other producers to pay CNR for all of that, but it clearly was not costs actually incurred by CNR as envisioned by Wellman, supra.

Sixth, the whole argument by CNR as to FERC misses the point regardless of who owned the lines at any particular time and what CNR was paying or what independent producers were paying CNR. CNR had no right to charge plaintiffs to transport, process, compress and dehydrate the gas in order to make it marketable.

Neither did CNR have the right to deduct for line loss due to its own poor line maintenance. CNR, conceivably, could make a business decision to not maintain its lines and, therefore, lose 50% of its gas but still net more money by charging plaintiffs for the line loss. CNR argues that it should be entitled to deduct that from plaintiffs' checks in its own discretion.

Seventh, even if the Court would find that deductions were allowed under some leases, what is fair and reasonable to charge other independent producers is not fair to lessors.

Further, there is no way defendants can meet the "actually incurred" as determined by an "accounting" because they never calculated nor charged plaintiffs in that manner. CNR charged a "postage stamp rate" which included costs from West Virginia, Kentucky and Pennsylvania and other states, all rolled up in one sum and then averaged the charges to each lessor. How could defendants even presume to claim a charge for a particular lessor when they charge everyone the same? Even FERC staff objected to the postage stamp rate. See Exhibit B to Plaintiffs' Response to Defendant Motion for Summary Judgment Re: Post-Production Deductions. The problem with defendants' approach to charging is that no individual lessor could even afford to challenge the amounts. It would take a firm the size of Arthur Anderson to begin to collect and challenge the data.

G. Defendants Misinterpret Wellman.

Defendants asks this Court to rule contrary to the specific holdings in Wellman, and, not only adopt and rely on "dicta" in Wellman, but expand it and ignore its specific and clear direction.

Defendants submit that the deductions which the defendants took are consistent with the law of West Virginia as set forth in the case of Wellman v. Energy Resources, Inc., 557 S.E.2d 254 (W.Va. 2001). Defendants initially note that the West Virginia Supreme Court of Appeals held in Syllabus Point 5 of Wellman:

If an oil and gas lease provides that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, the lessee shall be entitled to credit for those costs to the extent that they were actually incurred and they were reasonable. Before being entitled to such credit, however, the lessee must prove, by evidence of the type normally developed in legal proceedings requiring an accounting, that he, the lessee, actually incurred such costs and that they were reasonable.

(Emphases added).

Defendants then argue that in the body of the opinion the Court held that "the lease in Wellman provided for calculation of royalty at the 'mouth of the well.' Defendants claim that this language indicates that the parties intended that the lessors would bear part of the costs of transporting the gas from the well to the point of sale. Thus, defendants argue that the West Virginia Supreme Court of Appeals held in Wellman that 'at the wellhead' language has meaning, i.e., that it specifies a royalty calculation at a point after costs for gathering, compression, etc. have been assessed." Further, defendants argue that Wellman is, therefore, consistent with cases from other jurisdictions, particularly Texas, Louisiana and California. Id.

Defendants' argument is without merit for at least four reasons. First, if the Court intended that the phrase "at the wellhead" meant that the parties intended that deductions for gathering, compression, and transportation be taken from a lessor's royalty payment, then the Court would not have adopted Syllabus Point 5 of Wellman, "[i]f an oil and gas lease provides that the lessor shall bear some part of the costs incurred between the wellhead and the point of sale, the lessee shall be entitled to credit for those costs to the extent that they were actually incurred and they were reasonable." (Emphases added). Rather, the Court would have specifically held that use of the phrase "at the wellhead" expressly establishes that the parties intended that the lessor shall bear its *pro rata* share of certain costs incurred between the wellhead and the point of sale and that the lessee shall be entitled to credit for those costs to the extent that they were actually incurred and reasonable.

Second, the legal holdings of the Court are contained in syllabus points. To the extent that the Court suggested in the body of the opinion that use of the phrase "at the wellhead" might indicate that the lessee intended for the lessor to share some part of the costs incurred is nothing more than mere *obiter dictum*¹² which neither constitutes binding precedent nor law of the case. Frazier & Oxley, L.C. v. Cummings, 214 W.Va. 802, 591 S.E.2d 728, 734 n. 8 (2003) ("the implied conclusion must be 'necessary to a

¹² The language in Wellman apparently relied upon by defendant CNR actually provides: "Although this Court believes that the language of the leases in the present case indicating that the 'proceeds' shall be from the 'sale of gas as such at the mouth of the well where gas . . . is found' might be language indicating that the parties intended that the Wellmans, as lessors, would bear part of the costs of transporting the gas from the wellhead to the point of sale, whether that was actually the intent and the effect of the language of the lease is moot because Energy Resources, Inc., introduced no evidence whatsoever to show that the costs were actually incurred or that they were reasonable." Wellman, 557 S.E.2d at 265 (emphases added).

decision in the case' or it is dicta, which neither creates precedent . . . nor establishes law of the case. . . ." (citations omitted)); In re Assessment of Kanawha Valley Bank, 144, W.Va. 346, 109 S.E.2d 649, 669 (1959) ("Obiter dicta or strong expressions in an opinion, where such language was not necessary to a decision of the case, will not establish a precedent"); Newman v. Kay, 57 W.Va. 98, 49 S.E. 926, 931 (1905) ("One of the best definitions of the term *obiter dictum* is said to be that . . . : `Dicta are opinions of a judge which do not embody the resolution or determination of the court, and made without argument, or full consideration of the point, are not the professed deliberate determinations of the judge himself; *obiter dicta* are such opinions uttered by the way, not upon the point or questions pending, as if turning aside from the main topic of the case to collateral subjects.'" (quoting Rohrbach v. Germania Ins. Co., 62 N.Y. 47, 58 (1875)); Ferrell v. Nationwide Mut. Ins. Co., 217 W.Va. 243, 617 S.E.2d 790, n. 5 (2005) (same; quoting above language from Kanawha Valley Bank and Newman); Walker v. Doe, 210 W.Va. 490, 558 S.E.2d 290 (2001) (holding in Syl. Pt. 2: "This Court will use signed opinions when new points of law are announced and those points will be articulated through syllabus points as required by our state constitution"; also noting at p. 295: "those statements included in a per curiam opinion that are not necessary to the decision reached in the case or those that are clearly beyond the legal points that are being resolved in an opinion qualify as `obiter dictum'"); Syl. Pt. 13, Medical Assurance of West Virginia, Inc. v. Recht, 213 W.Va. 457, 583 S.E.2d 80 (2003) ("New points of law . . . will be articulated through syllabus points as required by our state constitution" (quoting Syl. Pt. 2, in part, Walker v. Doe, *id.*)); Woodrum v. Johnson, 210 W.Va. 762,

559 S.E.2d 908, 921 (2001) (noting “[t]his Court has also repeatedly cautioned against establishing precedent based upon dicta” and “a dissent to dicta is like the sound of one hand clapping.” “Law must be written with care. It is meant to be an exercise of the mind, not a venting of the spleen.” (quoting Pittsburgh Elevator Co. v. West Virginia Board of Regents, 172 W.Va. 743, 310 S.E.2d 675, 690 (1983) (Neely, J., concurring in part and dissenting in part))); Rogers v. Albert, 208 W.Va. 473, 541 S.E.2d 563, 566 n. 9 (2000) (“As dicta, the quoted language . . . clearly has no *stare decisis* or binding effect upon this Court”).

Third, if it “might” mean something, it “might not” mean it as well. Therefore, if language in an oil and gas lease does not clearly and unequivocally establish a matter but rather only “might” mean something then it is clearly susceptible to more than one meaning and, therefore, is ambiguous and must be construed against the lessee. See Martin v. Consolidated Coal & Oil Corp., 101 W.Va. 721, 133 S.E. at 628 (oil and gas leases are construed in favor of lessor and against lessee); Flanagan v. Stalnaker, 216 W.Va. 436, 607 S.E.2d at 769-770 (same); Wehner v. Weinstein, 216 W.Va. 309, 607 S.E.2d 415, 421 (2004) (“Whenever the language . . . is reasonably susceptible of two different meanings or is of such doubtful meaning that reasonable minds might be uncertain or disagree as to its meaning, it is ambiguous.” (citation omitted)); Williams v. Precision Coil, Inc., 194 W.Va. 52, 459 S.E.2d 329, 342 n. 23 (1995) (“A contract is ambiguous when it is reasonably susceptible to more than one meaning in light of the surrounding circumstances and after applying the established rules of construction. Whether a contract is ambiguous is a legal question reviewable by this Court de novo.”).

Fourth, it is rather surprising that the defendant would suggest that the Court's reasoning in Wellman is consistent with that of other jurisdictions such as Texas and Louisiana, when the Court in Wellman in reaching its holding expressly rejected and declined to follow the holdings and reasoning of courts in Texas and Louisiana, instead following the rationale and holdings of courts in Colorado, Kansas, and Oklahoma. Wellman, 557 S.E.2d at 264-65.

The West Virginia Supreme Court declined to follow the reasoning and holdings of cases from Texas and Louisiana and instead found the reasoning of cases from Colorado, Kansas, and Oklahoma persuasive and consistent with the law of West Virginia. Contrary to defendant CNR's suggestion otherwise, deductions taken by defendants were and are contrary to the law of the State of West Virginia and other states.

The Texas holdings are illogical and not even based on traditional rules of construction for contracts. Texas has long been among those jurisdictions which purportedly recognize the principle that oil and gas leases are generally considered to be the equivalent of insurance contracts which as contracts of adhesion must be strictly construed against the lessee with any ambiguity being resolved in favor of the lessor. Ladd v. Upham, 58 S.W.2d 1037 (Tex.App. 1933) (holding that "proceeds" means the amount realized from the sale of property and that oil or gas leases "are looked upon somewhat in the same light as contracts of insurance. . . . What is true of insurance contracts, may be said to be true of oil or gas leases (if not mining leases). The lessor usually knows nothing of the law applicable to such instruments; while the operator is

usually well informed. Years of experience have shown the operator how to draw a lease giving him many advantages, of which the lessor has not even thought. For this reason the courts have adopted a rule to the effect to construe an oil and gas lease most favorably to the lessor, where its terms can be so construed without doing violence to the language used.” (quoting Thornton, Law of Oil & Gas, Vol. 1, § 251)).

Defendants place considerable reliance on Middlestaedt v. Santa Fe Minerals, Inc., 954 P.2d 1203 (Okla. 1998). But, the facts of Middlestaedt were different from the facts in either Wellman or the facts presented by the certified questions in this case. In the case before this Court, it is admitted by defendants that the gas is not marketable at the wellhead. In Middlestaedt, supra, it is clear that the gas was made marketable and then the lessee transported the gas and further processed the gas to make it even more marketable, a fact situation which does not arise in West Virginia with these defendants because the gas is not marketable until it is processed and delivered to TCO’s line. That is probably why this Court did not cite Middlestaedt or analyze it in deciding Wellman. Middlestaedt actually supports plaintiffs’ position in this case. The Oklahoma Supreme Court stated, “I would accordingly respond to the certifying court by stating that in Oklahoma the lessee is responsible for all marketing costs until a first marketable product is obtained.” Id. at 1218. In fact, the Court reiterated, “We then said that if a lessee wants royalty owners to share in the post production costs then that must be stated in the lease.” Id. at 1206. The question before the Middlestaedt Court was whether “blending costs” to an already marketable product can be proportionately

charged to lessor. Id. at 1209-1210. Obviously, that is not the issue before the Court in the case at bar.

However, despite paying lip-service to the rule that oil and gas leases shall be strictly construed against lessees, the highest court of Texas has consistently placed the interests of oil and gas producers/lessees over the interests of landowners/lessors. The case of Heritage Resources, Inc. v. NationsBank, 939 S.W.2d 118 (Tex. 1996), which is cited and relied upon by defendant in its brief, is a prime example of the Texas Supreme Court doing so despite even the existence of lease language favoring lessors by expressly disallowing specific deductions.

In Heritage Resources, cited by defendants in support of its position, both the trial court and the court of appeals had ruled in favor of the lessors, holding that the royalty clauses at issue "showed the parties' intent not to deduct the post-production transportation costs when determining market value at the well." Heritage Resources, 939 S.W.2d at 120 (citing Heritage Resources v. Nationsbank, 895 S.W.2d 833, 839 (Tex.App. 1995)). The royalty clauses at issue were contained in three different leases, all of which provided that royalties would be paid to the lessors based upon "market value at the well" of the gas "provided, however, that there shall be no deductions from the value of Lessor's royalty by reason of any required processing, cost of dehydration, compression, transportation or other matter to market such gas." Id., at 120 (emphases added).

Despite the apparently clear and unambiguous language of the lease expressly disallowing any such deductions for "post-production" costs to be made, the Supreme

Court of Texas overruled the court of appeals and held that the "terms 'royalty' and 'market value at the well' have well accepted meanings in the oil and gas industry" which allows such post-production costs to be deducted and which "renders the post-production clauses [disallowing such deductions] surplusage as a matter of law." Id., at 121-22.¹³ This holding is the law of Texas, but it has no place in West Virginia jurisprudence.

The Supreme Court of Texas in Heritage Resources demonstrated its inherent bias in favor of lessees/oil and gas producers which is found in Texas and Louisiana. West Virginia, Colorado and others have chosen the historically solid positions that the lessors are to get one-eighth (1/8) and the lessee is to get seven-eighths (7/8), as they bargained for.

H. The Gas Is Only Marketable When The Gas Is In A Condition And Location Acceptable For Market.

The Colorado Supreme Court in Garmon v. Conoco, supra, stated "the common thread connecting these theories is the existence of an obligation upon the lessee . . . to complete all operations necessary to market the gas produced from the leasehold." Garman, at 659. The explanation for when the gas becomes marketable is

¹³ Such holding by the Texas Supreme Court of Appeals violates numerous rules of construction, including that industry custom and usage cannot be utilized to determine the intent of the parties when the language at issue is clear and unambiguous and that industry custom and usage cannot be offered as evidence of the parties' intent unless it is first shown that it was known and relied upon by both parties, lessor and lessee, when entering into the contract. As previously noted, numerous courts and commentators have acknowledged that attributing to language used in oil and gas leases special meanings which are purportedly known within the oil and gas industry is generally not appropriate inasmuch as such industry custom is normally not known by lessors who are typically unsophisticated, lay people.

set forth in Garman, at 661: "Our answer is limited to those post-production costs required to transform raw gas into a marketable product."

As the Court in Rogers held, gas is marketable when:

(a) it is in the physical condition such that it is acceptable to be bought and sold in a commercial market place, and

(b) it is in the location of a commercial marketplace,

such that it is commercially saleable in the oil and gas marketplace. Rogers v. Westerman Farm Co., 29 P.3d at 906.

The Oklahoma Supreme Court held that costs for dehydration, compression and gathering are not chargeable to lessors because such processes are necessary to make the product "marketable." TXO Production Corp. v. Commissioner of Land Office, 903 P.2d 259, 263 (Okla. 1994). (Also Gilmore v. Superior Oil Co., 388 P.2d 602, 605-607 (Kan. 1964) held "no part of the costs of marketing or of preparation for sale is chargeable to the lessor. This is supported by the general current of authority.") See also West v. Alpar Resources, Inc., 298 N.W.2d 484, 490-491 (N.D. 1980)(disallowing deductions); California Co. v. Udall, 296 F.2d 384 (D.C. Cir. 1961)(Lessee required to pay to make gas marketable); Hanna Oil & Gas Co. v. Taylor, 759 S.W.2d 563, 564-565 (Ark. 1988)("Proceeds" means "total proceeds" and lessee can't deduct).

Then in Rogers, the Colorado Supreme Court further elaborated on the definition of marketable with reference to the post-production expenses. The Court in Rogers reasoned:

In order to resolve the dispute between the parties in this case, we must define marketability under Colorado law, and specifically under the implied duty to market found in every oil and gas lease. . . . [W]e believe that the more accurate definition of marketability includes both a reference to the physical condition of the gas, as well as the ability for the gas to be sold in a commercial marketplace.

Rogers, 29 P.3d at 903 (emphasis added).

In looking to the first-marketable product rule for guidance in defining marketability, we must look to the practical implications of such a rule. In defining whether gas is marketable, there are two factors to consider, condition and location. First, we must look to whether the gas is in a marketable condition, that is, in the physical condition where it is acceptable to be bought and sold in a commercial marketplace. Second, we must look to location, that is, the commercial marketplace, to determine whether the gas is commercially saleable in the oil and gas marketplace.

x x x

It may be, for all intents and purposes, that gas has reached the first-marketable product status when it is in the physical condition and location to enter the pipeline. See TXO Prod. Corp., 903 P.2d 259, 262-63 (implying that the standard for determining when gas is marketable is when it is fit to enter the pipeline, because costs of dehydration and gathering, which are required in order for the gas to enter the pipeline, are expenses borne by the lessee as part of the duty to market gas, and are not deductible expenses from royalty payments); R.E. Yarbrough & Co., 122 IBLA 217, 223 (1992) (gas not in marketable condition until prepared for delivery into pipeline); Wyo. Stat. § 30-5-304 (2000) (lessee pays all non-deductible costs of production including costs of gathering, compressing, dehydrating, and transporting the gas into the market pipeline); Jay G. Martin, Summary of Significant Gas Market and Transportation Changes Affecting Producers in the 1990's, 37 Rocky Mtn. Min. L. Inst. § 16.01 (1991) (production function of gas industry includes producer being responsible for "putting the gas into a marketable state by removing its impurities and gathering the gas from the various points of production (wellhead), and delivering it via gathering lines to a common point for delivery into the large diameter transmission lines").

Rogers, 29 P.3d at 903-06 (emphases added; footnotes omitted).

Wellman may go beyond the above authority to a simpler definition and rule of law. West Virginia's Supreme Court in Wellman stated that the "lessee must bear all costs incurred in exploring for, producing, marketing, and transporting the product to the POINT OF SALE." Wellman at 265 (emphasis added). The point of sale of all of the leases is at least at TCO's transportation line if not at the ultimate purchaser. Therefore, marketable could be defined as the cost of making the gas acceptable for purchase at TCO's facility or the pool where it is sold.

The plaintiffs' gas required transportation to a pipeline and to go through processing to remove impurities. Therefore, clearly, applying Wellman, Garman and Rogers, supra, the gas was not marketable until it at least reached the TCO (Columbia Gas Transmission) pipeline where it was admittedly sold.

I. **The Leases Do Not Require Submission To A Fact-Finder Where The Lessee Does Not Include Plain Language In Its Own Leases From Which It Claims Its Entitlement.**

Defendants argue that they are entitled to have a fact-finder determine the intent of the parties to each of the leases in question. However, in this instance, courts have uniformly held that in oil and gas leases such contracts will be liberally construed in favor of the lessor and strictly against the lessee. Martin v. Consolidated Coal & Oil Corp., 101 W.Va. 721, 133 S.E. 626 (1926). Further, in choosing among reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words from whom a writing otherwise proceeds. Restatement 2d, Contracts, § 206.

It is the duty of the lessee to include language in the contract that plainly states the lessee's intention, particularly where the defendants wish to charge plaintiffs costs without telling them about it. Wellman, at 265. Defendants admit that ambiguities are to be construed against them. Defendants' Brief at 43. They claim that even if the Court finds that some person might construe the contract as maybe allowing for deductions and even if the "at the well" language could be interpreted as ambiguous, the rule for strict construction against lessee does not apply.

J. IOGA And WVONGA

This case is not against any independent producer. Nevertheless, IOGA and WVONGA filed amicus briefs opposite plaintiffs. IOGA argues in its brief that plaintiffs are advocating a profound change to the law in West Virginia. WVONGA claims it is a radical departure from Wellman. How could anyone reasonably state this when it is admitted deducting from plaintiffs' royalty was never done until 1993? Further, comparing oil and gas leases to coal leases, which are not before the Court, is not helpful. It is absurd to suggest possible unverified language that might appear in a coal lease for the purpose of conjuring up unknown complications not before the Court.

IOGA cites this Court to various cases for the proposition that "at the well" has specific, well-understood meanings in the natural gas industry, i.e., Maryland v. Louisiana, 451 U.S. 725, (1981), etc. See IOGA Brief at 5-8. But, these cases do not support defendants' position. Further, West Virginia landowners are not required to be versed in FERC proceedings or taxing decisions by every state in the union. West Virginia contract construction requires the Court to look at the contract language based

upon ordinary, reasonable landowners, not an expert in oil and gas regulation and taxation.

What IOGA, WVONG, and defendants in this case omitted telling this Court is that the previous practice of dealing with costs associated with transportation, processing, etc., was not borne by lessors or lessees but by the customers of lessees. Under the present law, natural gas owners are entitled to recover from their customers all legitimate costs associated with the production, processing and transportation of natural gas." Maryland v. Louisiana, at 748. Therefore, attempting to bootstrap their argument for deductions to the prior practice is not helpful to defendants, but actually supports plaintiffs.

WVONGA argues that if the Court concludes deductions are not proper, it should limit recovery back to 2001, because Wellman was a radical departure from existing law. Of course, the reverse is true. It was a radical departure from existing practices for lessors to deduct all these charges from landowners. Since this argument was not a departure from existing law, the Court should not limit retroactivity. Further, that question is not before the Court. (See WVONGA Brief at 16-17.)

WVONGA also argues that this will have a negative impact on the development of the oil and gas industry. But there is no basis for that assertion. Further, even if that were true, the issues at hand are contractual rights duly bargained for. Defendants could have re-negotiated the leases, or attempted to, if the economics were seriously affected.

WVONGA also argues that the historical point of sale was at the wellhead. See WVONGA Brief at 21-23.) In other words, defendants claim that the landowners can be charged for expenses simply because TCO and CNR decide to do so. West Virginia landowners were not party to FERC's proceedings, to the dealings between CNR's customers and CNR or TCO and IOGA or WVONGA members. Those parties could shift the cost of gathering, etc. to the customer where it always was. Certainly, it is not necessary to "shift" the cost to the landowners 12.5%.

K. Line Loss Is The Responsibility Of Lessee.

While defendants argue that they should be allowed to deduct losses from transportation due to their own negligence, such a result is not provided for under the law or by the leases themselves.

1. Wellman holds that there is an implied covenant of marketability in West Virginia to the point of sale and that there are no deductions allowed unless specifically stated in the lease. Then, and only then and only the specific ones are allowed if they are (1) actual, (2) reasonable, and (3) verified by accounting.

2. Line loss is not allowed to lessors because it is the responsibility of the lessee to transport. It would be absurd to give the lessee a blank check to deduct line loss from its lessors. "What is the producer/lessor's 7/8 for?" Poor management, poor line maintenance is not a chargeable expense to a lessor.

3. Fuel consumption for processing should not be charged to a lessor either. Again, lessee is simply trying to take more than its 7/8 to do its job.

4. "Constituents" are plaintiffs. They are not to be managed as if they belonged solely to lessee. CNR's math does not add up. If constituents are worth more than natural gas and they are; and, if CNR has the responsibility to process the gas, and they do, CNR is getting a free ride at the lessor's expense. If CNR has the responsibility to pay plaintiffs for value of constituents, the value is what the constituents are worth -- not equal BTU of natural gas. If CNR paid for processing, the lessor would receive full royalty for the metered volume of gas plus the value of constituents sold. Further, contrary to defendant's assertions, CNR does sell constituents.

L. Treating All Leases Identically -- Pool Prices.

Defendants admit that it treats all lessors the same regardless of lease language. The importance of this is, as pointed out in plaintiffs' brief, it proves that CNR finds the differing royalty clauses unimportant and irrelevant in distinguishing their duties to pay lessors.

The real importance of the "pool" is that it proves without doubt that CNR does not sell any lessor's gas from the wellhead. No one purchases it there. All gas is put into TCO's line and becomes part of the average price. Lessors' gas no longer maintains any individual characteristic. That is the way it is bought and sold. Therefore, it is impossible for CNR to prove anyone's gas was sold at the well.

M. West Virginia Adopted The Marketable Condition And Location Rule.

CNR takes a convoluted trip through Wellman, Garman and other cases to come to the conclusion that Wellman adopted marketable condition not marketable location. There really is no debate to this absurd position because the West Virginia Supreme

Court in Wellman requires that "the lessee must bear all costs incurred in exploring for, producing, marketing and transporting the product to the POINT OF SALE." Wellman, at 265. Obviously, they did not limit CNR's duty to put the gas in a marketable condition; they require CNR to deliver it.

N. Unmetered Wells.

There are hundreds of wells where CNR has never placed meters. The significant number of unmetered wells demonstrates that defendants do not sell gas at the wellhead. While plaintiffs are damaged by this misconduct, this serves as further evidence that "at the wellhead" is a meaningless phrase for deducting gathering and processing charges or determining marketability.

O. Defendants Violated Their Leases By Selling To Subsidiaries And Discounting Gas For Upfront Cash And Must Compensate Plaintiffs For The Actual, Reasonable And Fair Price Of Their Gas Without Deduction -- Sweetheart Deals, Hedging, Forward Sales, And Liquids Prove That Sales Are Not At The Wellhead.

Defendants made intra-sales to sister companies, failed to pay for constituents extracted from gas, and made forward sales to offshore companies. Those issues remain for future consideration. Plaintiffs do have claims for misconduct relating to damages caused plaintiffs directly by defendants engaging in these activities. However, the reason plaintiffs highlighted this conduct by defendants is to prove that the sales of plaintiffs' gas were never at the wellhead. The market was never at the wellhead and the gas was never in the condition to be marketed at the wellhead.

Defendants argue that, "plaintiffs have alleged that they were entitled to be paid royalties based upon fair market value" without quoting lease language, which entitles

plaintiffs to "fair market value." Defendants' Brief at 5-6. Defendants did not disclose to this Court that besides its own misconduct the contract itself entitles plaintiffs to fair market value. Defendants attack plaintiffs' request that they be paid a reasonable fair market value for their gas because defendants violated its duties under all the leases. Defendants are required to make arms length sales of its gas. Defendants sold the gas forward for a discounted price, essentially a loan for defendants' benefit. By doing this, regardless of defendants' right to determine the "time and method of marketing," they forfeited that right, breached the contract, and destroyed the lessors' opportunity to attain an arms length open market sale of their gas.

Defendants sent monthly statements to plaintiffs on which defendants stated affirmatively that there was "0" deductions from their royalty and which represented that defendants received an amount certain for their gas. This figure was false.¹⁴ Therefore, defendants' argument that there was no "lease provision" which state specifically that defendants are to provide truthful statements that show accurate price, volume and deductions as well as royalty.

P. The Fact That Defendants Are "Sophisticated" Or That Attorneys Reviewed Some Of The Leases Does Not Relieve The Defendants From Their Duties Under The Leases.

Defendants seem to suggest that because one landowner may be more knowledgeable than others or they may have sent the lease to an attorney for review somehow relieves the defendants from their responsibilities under the leases.

¹⁴ See Deposition Transcripts of Mark Chandler, Rule 30(b)(7) witness, at 64, 74-77, and Henry Harmon at 141, 151.

The holdings in Wellman, Garman, Rogers, supra, and other cases and authorities recognize that implied covenants require the lessee to pay for making the gas marketable and to transport it to market. This implied duty applies to all leases. There is no law that exempts lessees from paying well-to-do landowners what is due them, but requires the lessee to pay poor landowners. Further, an attorney reviewing a lease would be entitled to rely on Wellman, Donley, Merrill, supra, and other law, or, for that matter, the plain meaning of lease language in passing on an instrument. Therefore, defendants' argument that some of plaintiffs may have relied upon advice of counsel or were sophisticated business entities argues the more that the lessees were misleading them all and had no right to these deduction based upon the lease language.

Moreover, leases from the "sophisticated" business entities were negotiated between 1908 and 1987.¹⁵ During this time the practice in the industry, and for defendants in particular, was to pay royalty without deduction of post-production costs. Indeed, large landowners, just like small ones, could only have contemplated that royalties would be, as the term "royalty" is commonly known, free of all costs of production and marketing.

¹⁵ See Columbia Brief, p. 45 for its list of "sophisticated" (p.46) business entities. The lease readily available to plaintiffs include: The Henry Closterman Trust leases, which are dated March 30, 1930, September 30, 1930, and April 14, 1932, Cole and Crane Real Estate Trust's lease which are dated September 15, 1952, Cotiga Development Company's leases which are dated December 5, 1929, January 10, 1939, and January 29, 1952, Dingess-Rum Properties lease which is dated June 1, 1971, Horse Creek Coal and Land's leases which are dated August 11, 1908 and June 5, 1915, Horse Creek Land & Mining's lease which is dated September 1, 1945, Kanawha-Gauley Coal & Coke Company's lease which is dated July 1, 1971, McCreery Coal Land Company's leases which are dated January 1, 1963 and June 22, 1967, Mingo-Wyoming Coal Land Company's leases which are dated July 1, 1951, July 6, 1953, and December 1, 1971, Southern Land Company Limited Partnership and Dickinson Properties Limited Partnership' lease are dated April 1, 1916, December 15, 1930, January 1, 1970, February 1, 1973, May 27, 1987, and May 1, 1964

Defendants admittedly did not commence deducting post-production costs from royalty until defendants' internal restructuring in 1993, long after each lease was negotiated. Thus, in practice, defendants themselves did not consider at the well to mean that a variety of costs can be deducted to arrive at a discounted value for royalty purposes. The artistry of defendants' interpretation is seen in the fact that a long standing practice under each of these leases was unilaterally changed in 1993 by defendants, and, not only was a change made, but it was done with the affirmative and false representation on each royalty check stub that no deductions were taken. This proves that defendants knew how to expressly and unambiguously state its intentions with respect to the deduction of expenses from royalty and that it is not necessary to try to hide its intention and the phrase "at the wellhead."

Significantly, the only lease of those listed which was amended after or during the 'restructuring' was the Cotiga lease, and, apparently tipped off to the new practice, the amendment provided: "[A]s of April 1, 1993, Columbia shall pay to Cotiga a production royalty equal to one-eighth of the sale price, received by Columbia at the wellhead, **without the deduction of any expenses**, for all oil, gas and the constituents thereof produced from wells located on the lands. . ." It is submitted that any lessor armed with the truth and all the facts would negotiate similar terms.

Q. Defendants' Methodology For Arriving At A Wellhead Price Is Not Mere Legal Fiction.

In 1940, Professor Merrill wrote that, "No part of the cost of marketing or of preparation for sale is chargeable to the lessor. This is supported by the general current

of authority.” Maurice H. Merrill, Covenants Implied In Oil and Gas Leases, § 85 at 214-215 (2d Ed. 1940) (emphasis added). In Wellman, *supra*, at 263-264, this Supreme Court, 61 years later, reiterated that proposition: “[I]t [royalty interest] is not chargeable with any of the costs of discovery and production.” This, according to Wellman, includes “the responsibility to get the oil or gas in marketable condition and actually transport it to market,” and “that the lessee should bear the costs associated with marketing products produced under a lease.” Id. at 264-265.

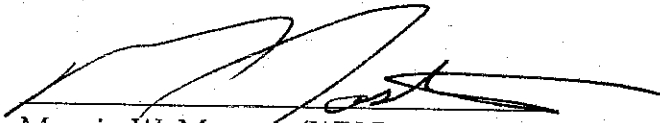
This Court recognized that there has been a “long-established expectation of lessors in this State, that they would receive one-eighth of the sale price received by the lessor.” Id. at 265. But, defendants claim that it can sell the gas at the TCO line, which they admit is the only place there is a market, and arrive at a price for the gas by taking a variety of deductions. While this could have been the manner of calculating royalty, it is a factual fiction to suggest that the price of something equals the price minus something else.

III. CONCLUSION

For the reasons stated, plaintiffs request the Court to affirm the answers to the certified questions by the Circuit Court of Roane County.

Respectfully submitted,

ESTATE OF GARRISON G. TAWNEY, by
LELA ANN GOFF, Executrix, et al.



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BEFORE THE WEST VIRGINIA SUPREME COURT OF APPEALS
No. 32966

ESTATE OF GARRISON G. TAWNEY, by
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LELA ANN GOFF and VERNON B. GOFF,
husband and wife, JANICE E. COOPER and
CLIFFORD R. COOPER, husband and wife,
LARRY G. PARKER, JOHN W. PARKER,
RICHARD L. ASHLEY, MYRTLE JONES,
by her Attorney-in-Fact, ORTON A. JONES,

Petitioners/Plaintiffs,

vs.

Civil Action No. 03-C-10E below
Circuit Court of Roane County

COLUMBIA NATURAL RESOURCES, LLC,
f/k/a COLUMBIA NATURAL RESOURCES, INC.,
a Texas corporation; NISOURCE INC., a
Delaware corporation; and COLUMBIA
ENERGY GROUP, a Delaware corporation,

Respondents/Defendants.

CERTIFICATE OF SERVICE

I, Marvin W. Masters, counsel for Plaintiffs, do hereby certify that true and exact
copies of the foregoing "Petitioners/Plaintiffs' Motion to Exceed Page Limit" and
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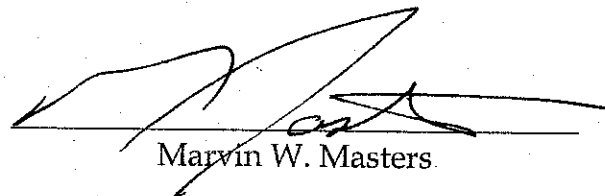
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in envelopes properly addressed, stamped and deposited in the regular course of the
United States Mail, this 31st day of March, 2006.



Marvin W. Masters